Impact of Rapid Growth of China and India on other Developing Countries

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Presentation for USAID Economic Growth Officers Workshop

Washington DC
October 15, 2007

Structure of Presentation

- Why Focus on these two Countries?
- Brief Historical Overview
- Parallels and Differences
- China India Assessment
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  - Weaknesses
  - Challenges
- China India Challenges and Opportunities to World
- Lessons from China and India Experience and Challenges to Washington Consensus
- Elements of Success in Chinese and Indian Rapid Growth
- Four Challenges for Development Policy
- Conclusion

Why Focus on These Two Countries?

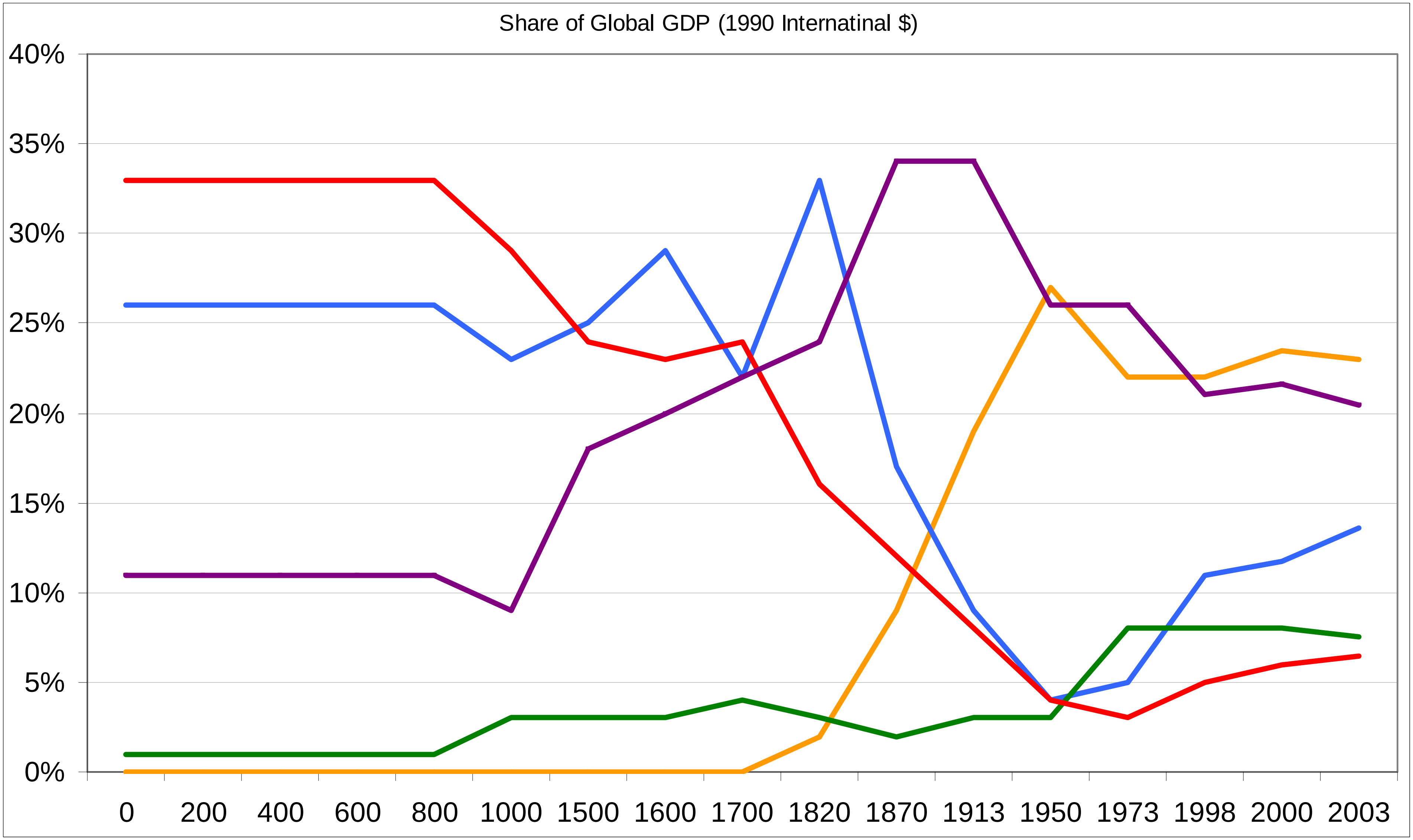
- Both have become major players on world stage and are challenging development policy because:
  - They did not develop usual way
    - With respect to conventional advice
    - Between their own development models
  - Are having major impact on both developed and developing countries
- Both have had significant industrial policy
- Probably neither could be where it is were it not for their industrial policy
- Are to some extent pre-empting traditional exporting strategy advice for other countries
- Are raising challenges of what to advice other developing countries

Gross Domestic Product Average Annual % Growth

	1990-2000	2000-2005
China	**10.6**	**9.6**
India	**6.0**	**7.0**
East Asia & P	8.5	8.4
Europe & C. A.	-0.7	5.4
Latin America	3.3	2.3
M. East & N. Afr.	3.8	4.1
South Asia	5.6	6.5
Sub Saharan Afr.	2.5	4.3
High Income	2.7	2.2

BASIC INDICATORS	China	India
GNI		
GNI (2005 nominal billion)	2,270	804
GNI as share of Global GDP	5.4	1.9
GNI/capita (2005 nominal)	1,740	730
GNI (2005 PPP)	8,610	3,787
GNI as share of global GDP 2005PPP)	14.9	6.6
GNI/capita(2005 PPP)	6600	3486
EXPORTS(2005)		
Merchandise Exports (billion)	762	95
Merchandise Exports % Share of World Total	7.3	0.9
Service Exports(billion)	74	56
Service Exports Share of World Total	3.8	2.9
PEOPLE		
Population (2005)	1,305	1,095
Population as Share of Global Population	20.2	17.0
Life expectancy at birth	72	64
POVERTY		
People living below $1/day (2004-2005)	9.9	33.5
People living below $2/day (2004-2005)	46.7	80.0

Two Millennium Perspective



Parallels

- Two most populous countries
- Both are still poor developing countries
- Are already having major impact on world
- Major regime change in mid 1950s
- Moved toward communist/socialist camp after regime change
- Both have contrast between inward oriented first phase with more outward oriented second phase

Differences

	China	India
Type of government	Authoritarian, one party rule	Democratic, multiple parties, weak coalition governments
Development Strategy since major regime change	Starts Communist, moves toward market economy and integrates to world faster	Starts as market economy, goes socialist for 40 years and slowly moves toward market liberalization
State ownership	Soon has 100% state ownership but begins to privatize in end of 1970s, moves to heavy privatization of state companies after 1995	Nationalizes heavy industry and eventually banking. Government ownership of commanding heights. Some privatization in 1990s and 2000s
Composition of GDP	Industry strongest (48% GDP vs. 40% services, 13% agriculture)	Service sector strongest (54% GDP, vs. 27% industry, 18% agriculture)
Consumption vs. Investment	Investment oriented	Consumption oriented
Trade	Very globally integrated-trade 71% GDP	Still one of closed economy-trade 37% GDP
FDI	Has made heavy use of FDI	Has made less use of FDI opened only recently
Technology Transfer	Extensive use	Less Extensive
Education	Invests in massive basic education, cultural revolution decimates higher education in mid 1960s, but then expands higher education rapidly after 1995	Makes early investments in elite higher education, neglects basic education. Early investments in quality higher education eventually pay off in late 1990s and 2000s
R&D	Majority of R&D already done by productive sector	Majority of R&D still done by public sector

Strengths

China	India
• GDP growth of 9-10% for over 30 years, now a major export power • Many people have moved out of poverty • Very strong industrial sector across broad range and increasing sophistication • Very competitive in manufacturing • Rapid rise in educational attainment, now has more students at tertiary level than US • Most integrated of large countries into global economy • Very high investment rates greater than 40% GDP since 2000 • Very attractive to foreign investors • Relatively well developed infrastructure	• Jumped from 2-3% growth of 50s-80s to 6% in 90s and 8% last 4 yrs • There has been some reduction in poverty • Strong service Sector, plus pharma and auto-parts • Very competitive in ICT and knowledge services • Core of English speaking educated population • Some trade liberalization and opening to FDI since 1991 • Increasing investment from 20% to 30% of GDP in last 4 years • Increasing foreign investment in last few years • Relatively well developed financial sector

Weaknesses

China	India
• Inefficiencies in allocation of investment (high ICORs) • Weak financial sector • Poor natural resource endowment per capita makes it dependent on foreign supplies • Rapidly increasing inequality among people, urban/rural, coastal vs. western provinces • Although large and growing manufacturing exports, with increasing % in high technology; very dependent on imported components, and half of exports done by MNCs • Is part of global production and distribution networks, but these are controlled by foreigners • Weak formal rule of law and enforcement	• Very high illiteracy rates, low educational attainment • Still not too inserted into international economy means lack access to modern goods and technology and less competition (still has reservation policy for smes) • Increasing inequality • Very small modern sector, 90% of workers in near subsistence economy • Very poor infrastructure except for growing cell phones • Extensive corruption and bureaucracy constrain foreign and domestic investment • Is still not well integrated into global production and distribution networks except for ICT services and few manufacturing areas (auto parts and pharmaceuticals) • Adequate formal rule of law, but very inefficient and corrupt court system

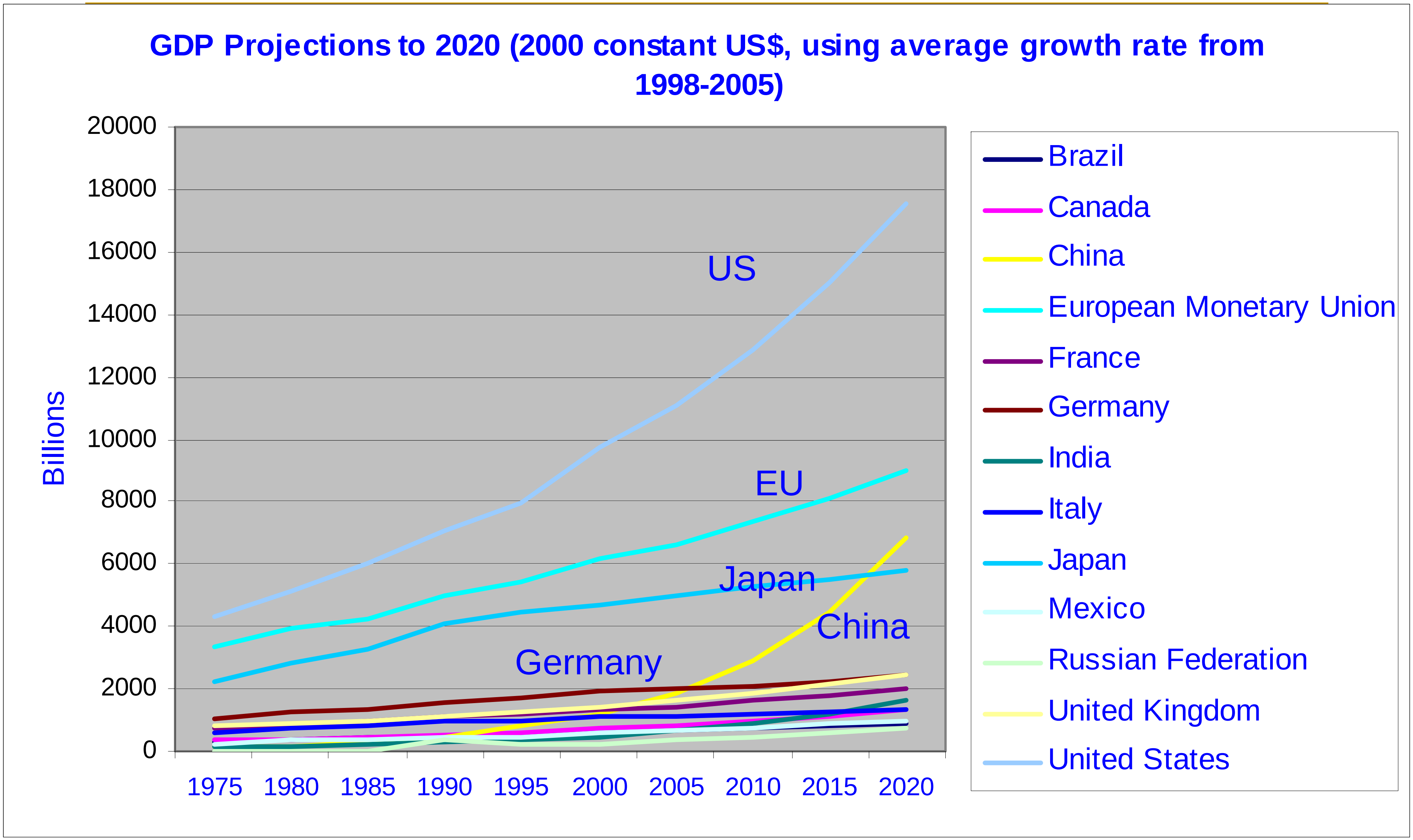
Challenges

China	India
• Growing environmental problems which could restrain or even choke growth • Rapid increase in inequality could be destabilizing, will need to better social protection mechanisms • Tension between movement towards decentralized market decision making and one party rule • Very dependent on trade with world--liability if there is turn towards protectionism	• Growing environmental problems, congestion in growth centers • Increasing inequality can be destabilizing if cannot focus on inclusive growth • Weak coalition governments have difficulty in passing and implementing reforms • Sustainability of growth is constrained by weak infrastructure, weak basic education base, and fragmented political system susceptible to manipulation and capture by vested interests

Challenges and Opportunities for World

- Challenges
  - Growing economic weight
  - Trade adjustment pressures
  - Growing geopolitical clout
  - Environmental footprint
- Opportunities
  - Growth
  - Innovation and Competition
  - Multi-polarity

Growth Projections to 2020 Constant Nominal Dollars



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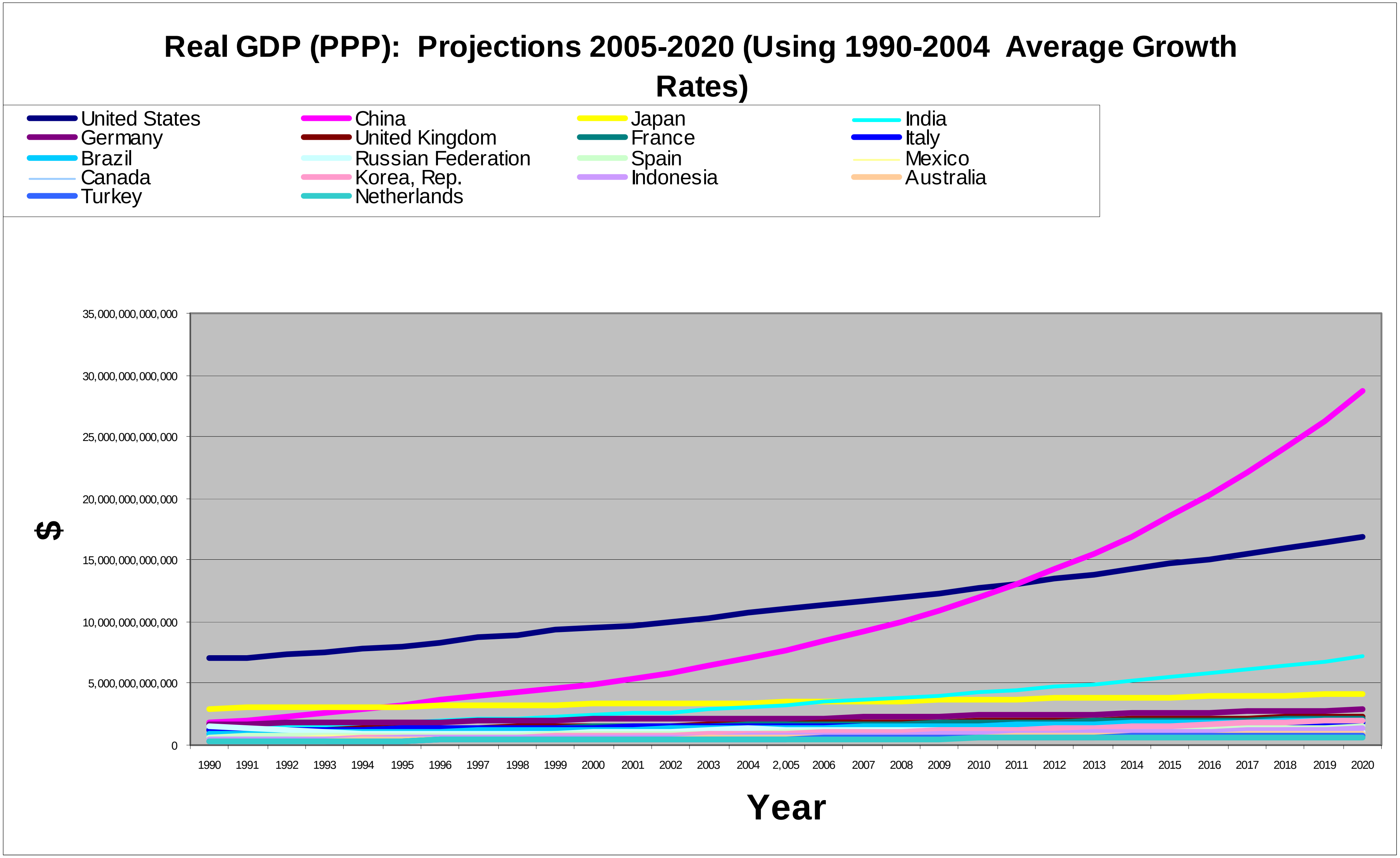
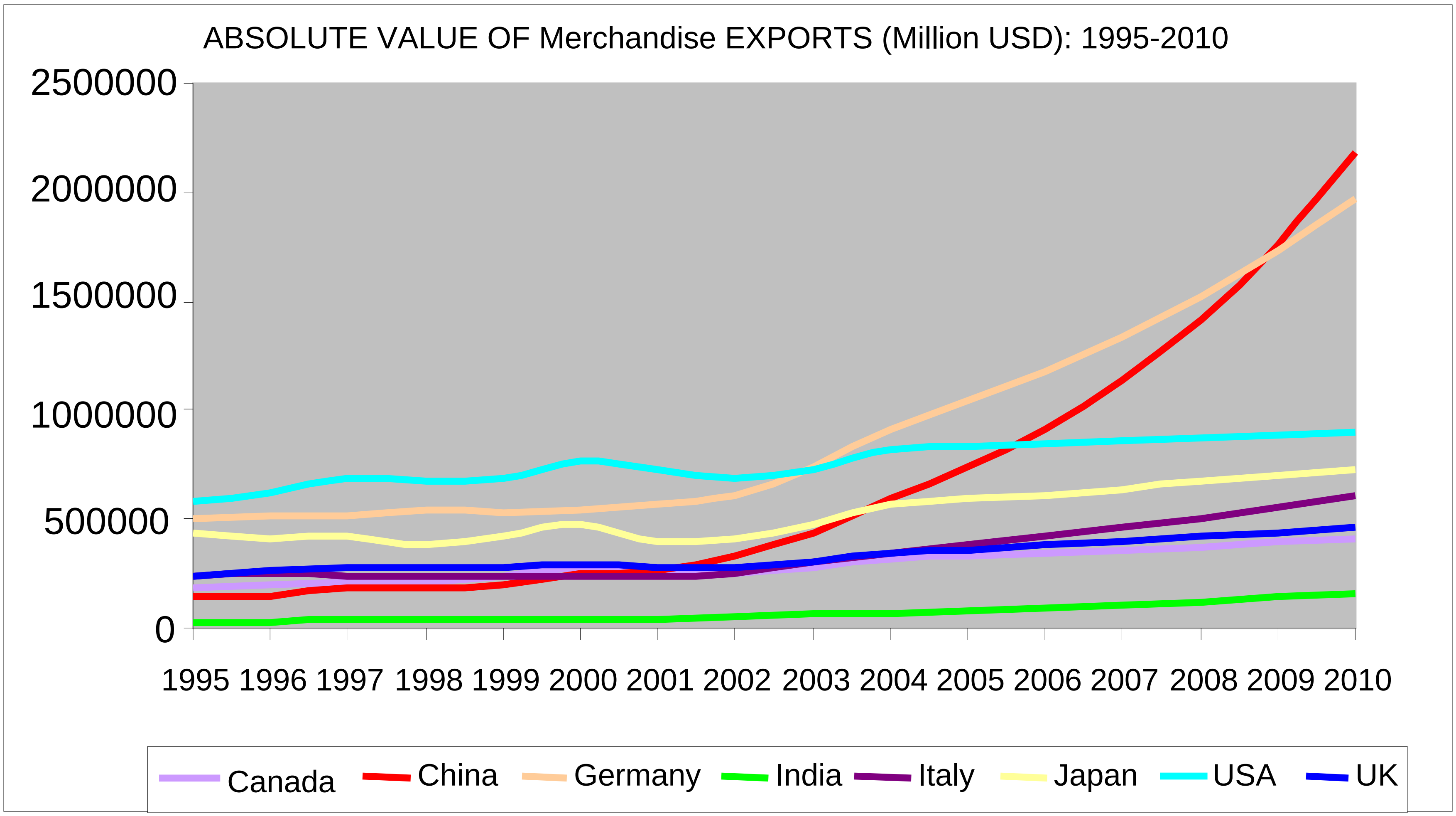
GDP Projections to 2020



China is 3rd largest Merchandise Exporter and Poised to Largest by 2010



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Share In Total Global Exports

	Merchandise		Services	
	1990	2005	1990	2005
China	1.8	7.3	0.8	3.8
India	0.5	0.9	0.7	2.9
All Low & Middle Income	17.9	29.3	15.8	25.3

China's Rise Affecting Global Prospects

- Speed, scale and scope of China's rise unprecedented i
- Major trade expansion not fastest, but certainly the largest with most implications for rest of world
- Its advantage is not just low wage labor (and still has reserve of 250 million underemployed in agriculture).
  - Most trade integrated of large countries-opening up even more with WTO
  - Integrated through FDI which brings it most advanced technology and direct and indirect supply chain links to global markets
  - Great economies of scale and specialization
  - Adopting all key new elements of competition
    - Investing heavily in education, particularly tertiary education
    - Massive investment in expanding and upgrading innovation system
    - Massive investment in IT use (and production too)
    - Strong logistics with continuous improvement and links to global markets

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Five General Impacts of China's Rise on Developing Countries

- **Positive** for world: additional growth pole
  - Imports of merchandise and services from rest of world
  - Investment opportunities for rest of world
- **Positive** for world: reduction of costs of manufactured products that can be produced in China
- **Positive** for world: increased saving rates
  - lower cost of capital
  - finance for US trade deficit through purchase of treasuries
- **Positive** for natural resource exporters
  - Increased commodity prices
  - Increased foreign investment in natural resources sectors
- **Negative** for exporters of manufactured goods
  - Competition particularly strong in labor intensive exports
  - But is also moving up technology ladder very quickly

Lessons from Development Experience of China and India

- Have done reform slowly, by bits and pieces not all at once
- China has done it more traditional way of labor intensive industry led exports; but India has done it through growth of skilled services and more skill intensive exports
- Do not conform to many elements of the Washington Consensus, yet have had admirable growth performance (China for more than 30 years, India has accelerated growth to 8% in last 4 years-and not directly linked to any major reform
- Revealing indicator of how they do not conform is that WEF Global Competitiveness Report Index ranks China 54 (48 in 2005) and India 43 (45 in 2005) most competitive countries, although arguably China is more competitive than India, and is eating many countries lunch, and both are significantly gaining global trade shares.]
- Investments in education have been very important for their success, although these have been different and have had different impacts and consequences

Elements of India Success

Recent surge seems to be result of :

- Earlier investment in technical education and English language
- India engineers ability to leverage successful response to Y2K
- Lack of overregulation of the new ICT sector
- Contracts and expertise from Indian Diaspora
- Indian entrepreneurship long repressed by the anti business governments
- Relatively recent opening up to FDI and foreign
- Growing integration into global system (trade in services, trade in manufactures)
- Fact that India is coming from being very far behind the global knowledge frontier so it has a lot of easy catch-up to do
- But note that
  - many of the traditional fundamentals of Washington consensus are still very non-conforming (still very protected, large fiscal deficit, etc)
  - demonstrates how growth was leveraged from knowledge and skill intensive rather than labor intensive exports in spite of serious infrastructure and overall poor investment climate

Elements of China's Success

China's success seems to be due to:

- Strong government with focus on economic growth and ability to implement
- Pragmatism, willing to draw on lessons from rest of world, adapt to Chinese conditions
- Gradual reform, experimentation and then rapid scale-up
- High savings and high investment rate
- Disciplined population
- Extensive tapping of foreign knowledge through trade; FDI; technology licensing; copying, reverser engineering, foreign education
- Effective management of FDI thanks to lure of large domestic market and good export platform
- Effectively drawing on Chinese Diaspora (Hong Kong, Taiwan, Singapore, Indonesia, Malaysia, Overseas Chinese in Europe and US)
- Strong investments in education and infrastructure

Challenges to Development Policy I--China and India Development Experience

- Got to where they are now through explicit industrial policy, although they have done do differently with different degrees of success and with different strengths and weaknesses
- Have benefited from large internal markets
- Have used them to develop technological capability
- Have benefited by tapping their Diasporas
- Now have critical mass in education and R&D innovation and are now beginning to deploy it
- Reflect the new international environment

Challenges to Development Policy II: From Size and Impact of China and India on Global System

- China and India are to some extent pre-empting development strategies for other developing countries because of first mover advantage and economies of scale
  - Not so helpful to advice countries to go for labor intensive exports of manufacture where China has such a large advantage (not just low wages but economies of scale in production, logistics and integration into global supply chains)
  - Or to get into ICT enabled services where India, has such large advantages and China is beginning to develop it massively too
- Impact of rise of global commodity prices which have brightened prospects of natural resource intensive countries likely to be short lived
  - Are cyclical (currently linked to rapid Chinese growth which could slow
  - Are beset with typical developing country problems of major leakages through corruption, misuse and Dutch disease
- There are some positive market opportunities, but these also require many of pre-requisites of more competitive international system and
- And China and India are likely to have low labor costs advantages for long period of time given economies of scale and abundant human resources, as well as to move up the technology ladder very quickly and import substitute

Challenges to Development Policy III: From Changing International Rules—not China India Specific)

- Global rules have also reduced the degrees of freedom that developing countries have to use some of industrial policy elements successfully used by China and India, and other economies before them-Korea, Taiwan, Japan, even US and Germany
  - Reduction of tariff and non tariff barriers
  - WTO monitoring and enforcement
  - Intellectual property tightening through TRIPs and WTO

Challenges to Development Policy IV-- Global system Now More Demanding

- More of a truly global market because of reduction of transportation and communication costs, traffic and non-tariff barriers—trade to GDP ratio has increased from 38% in 1999 to 57% in 2005 imply increased competition
- Doubling of labor force competing in global market
- Speed up in creation and dissemination of knowledge. Knowledge is global, strong incentive to exploit it on worldwide scale to get maximum returns
- Large economies of scale in purchasing, branding, advertising and distribution
- Speed and quality are of the essence for global competitiveness
- MNCs account for 27% of global value added, 2/3 of world trade (half of which is intra-firm) and more than 50% of global R&D. They are main agent of globalization and integration of global markets
- Education and skills are essential go compete in this new more demanding environment
- Trade logistics and physical and ICT infrastructure are increasingly important to compete in this new system
- Whole parts of world are being left out except for current boom in commodity prices favoring natural resource exporters
- There is increasing inequality with-in countries and across countries

Characterization of China and India as Exemplars of new Global Environment

- China is the unbundling of manufacturing—based on logistics of physical trade, aided by ICT and insertion into global production and distribution chains [but China is moving to the task unbundling too]
- India is the unbundling of tasks—based largely on possibilities opened up by new ICT infrastructure which has allowed it to overcome constraints of physical infrastructure
- Both are very fast followers to new technology, China in manufacturing, India in services
- Both have been successful to a large extent to their innovation (defined broadly as technology that is new to country) and education strategies

Conclusions

- China developed faster and for longer, but may have larger challenges in future
- India has developed slower, but may be more robust
- Both have benefited from globalization but in different ways
  - China from first unbundling—manufactures
  - India from second unbundling—digitally enabled trade
- Have followed different strategies
  - China intense focus on investment and manufacturing
  - India on consumption and services
- Both are becoming major players
  - Economically
  - Politically
  - As major educational platforms and innovators
- Hard to predict future-big potential but daunting challenges for each

Implications for Development Policy

- China and India re-emergence some what sudden and unexpected
- Followed different development paths that challenge Washington Consensus
  - Protection and IPR
  - Governance and rule of law
  - Greater focus on higher education and innovation
- There are some important common elements
  - Opening up to world (but different speed and sequencing and under their own control)
  - Investments in education (though different in focus and sequencing)
  - Investments in ICT (though different emphasis)
  - Investments in innovative capability (though with different emphasis & results)
- Their strategies may be hard to replicate
  - Large market size
  - Critical mass in human capital and R&D
- They reflect in part what is necessary to compete and prosper in new more demanding international system
- May be pre-empting development options for other developing countries
- Therefore we need to re think what advice to give to other developing countries-not easy to see how they can compete successfully in this more demanding global context
  - Challenge is particularly acute for Africa
  - But it is also serious for advanced middle income countries such as Brazil and Mexico
  - and countries in between

THANK YOU !

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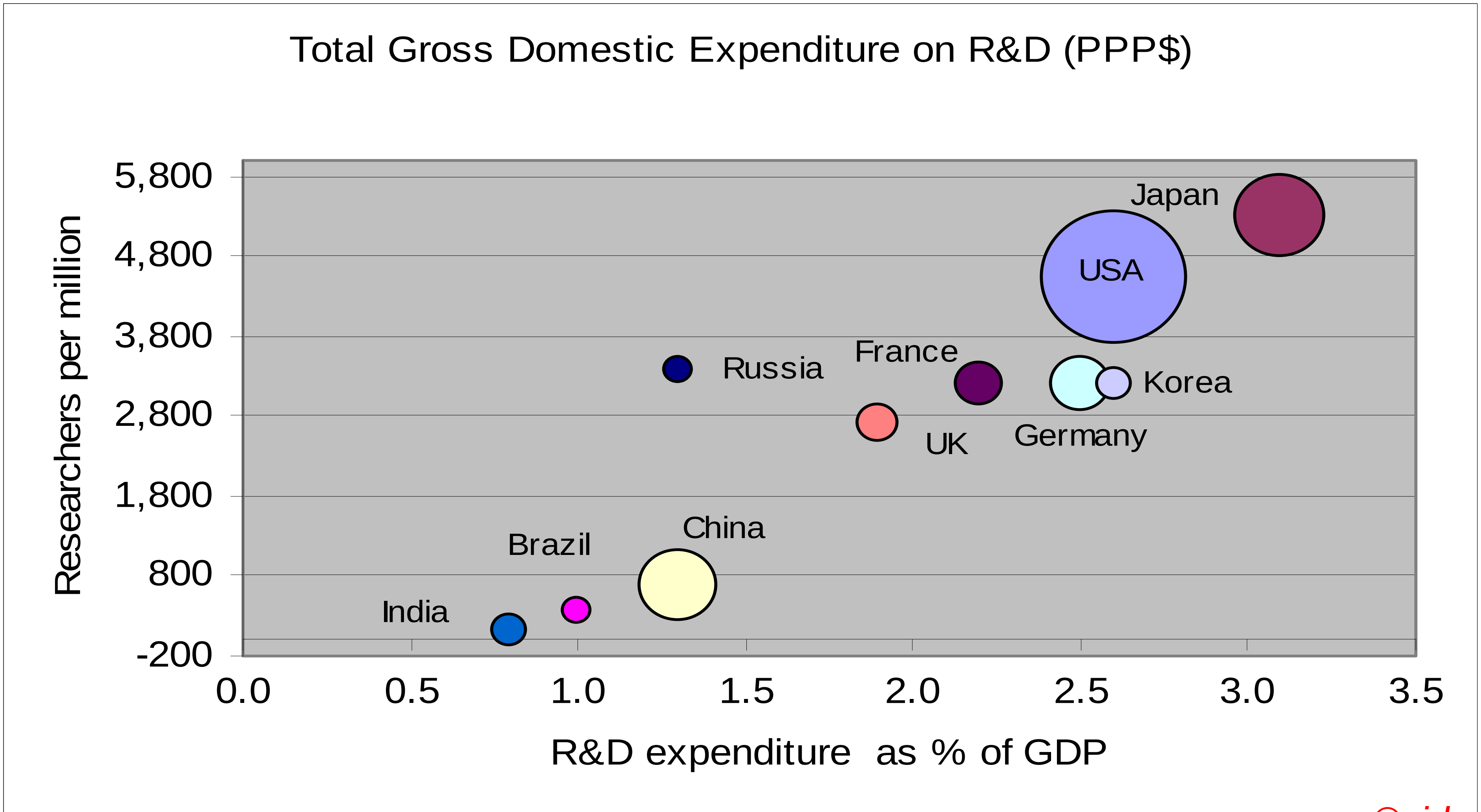
Changing Structure of World Merchandise Export 1985 vs. 2004: Primary vs. Manuf. by Tech, Intensity

Products	**1985**	**2004**	**Annual Growth Rate**	**1985 %**	**2004 %**
All Products	**1,689**	**7,350**	**7.6**	**100.0**	**100.0**
Primary products	**391**	**1,018**	**4.9**	**23.2**	**14.7**
Manufactured products	**1,244**	**6,063**	**8.2**	**76.8**	**85.3**
Resource based	327	1,148	6.5	19.4	15.6
Low technology	239	1,962	7.9	14.2	15.0
Medium technology	480	2,169	7.8	28.5	29.5
High technology	196	1,643	11.2	11.6	22.4

China's Growing R&D Strength



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Growth of Merchandise Exports

	1980-1990 (av. annual rates)	1990-2005 (av. annual rates)
China	12.8	15.5
India	7.3	9.7

China and India vs. Washington Consensus

	China	India
Fiscal Policy discipline	Yes	No
Redirection of public spending toward pro-growth, pro-poor services	Yes especially current government	Not yet, paying lip service, but not much real action
Broadening tax base, lower marginal tax rates	Somewhat	Somewhat
Market determined interest rates	Not quite, still subsidized and credit administered	Yes, although much credit still administered
Competitive X rates	No-managed and undervalued	Yes, but currently -overvalued
Trade liberalization	Yes significant	No still one of most protected economies
Liberalization of FDI	Yes, significant, now one of largest host to FDI	Some, but still prohibited or restricted in many sectors
Privatization of state enterprise	No, significant compared to past, but state ownership still strong	No, more marginal from smaller public base than China, but still far to go
Deregulation	No, significant compared to past, but much more to go	No, some compared to past, but much more to go
Legal security for property rights	No, in theory since 2004, but still poor implementation*	No, in theory since British, but courts notoriously corrupt and resolution lengthy
Number of conforming	3	2
Number of qualified	2	2
Number of non-conforming	5	6

Washington Consensus -Adjusted for Direction of Change

	China		India	
Fiscal Policy discipline	Yes		No	
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Legal security for property rights	No, in theory since 2004, but still poor implementation*		No, in theory since British, but courts notoriously corrupt and resolution lengthy	
Number of conforming	3	(7)	2	(7)
Number of qualified	2	(1)	2	(0)
Number of non-conforming	5	(2)	6	(3)